Report

of the

Examination of

Liberty Mutual Fire Insurance Company

Stitzer, Wisconsin

As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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August 23, 2002

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2001, of the affairs and financial condition of

LIBERTY MUTUAL FIRE INSURANCE COMPANY
Stitzer, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1997 as of December 31, 1996. The current examination covered the intervening time period ending December 31, 2001, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on January 6, 1872, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the German Mutual Fire Insurance Company of the Town of Liberty. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were no amendments to the articles of incorporation or amendments to the bylaws.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Crawford, Grant, Iowa, La Crosse, Lafayette, Monroe, Richland, Sauk, and Vernon.

The company is currently licensed to write property, including windstorm and hail, and non-property insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year with premiums payable on the advance premium basis.

Business of the company is acquired through 37 agents, one of whom is a director of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
Homeowners and Farmowners	16%
Mobile Homeowners	16%
Commercial	15%
Dwelling Fire and Farm Fire	15%
Mobile Home Fire	15%
Preferred Farmowners	12%
Special Farmowners	10%
New Policy Bonus	$5.00

Agents have no authority to adjust losses. Adjustments are completed by the company manager, who is reimbursed at 34.5¢ per mile for mileage.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. The directors may fill vacancies on the board for the interim to the next annual meeting, when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Bernard Keller*	Insurance Agent/Farmer	Stitzer, WI	2003
Gary Schneider	Farmer	Lancaster, WI	2003
James Reed	Farmer	Platteville, WI	2004
John Wall	Farmer	Eastman, WI	2003
Maurice Grim	Carpenter/Contractor	Richland Center, WI	2002
William Frankenhoff	Farmer	Boscobel, WI	2002
Terry Runde	Farmer	Platteville, WI	2004
Gerald McCauley	Loan Officer	Richland Center, W	2002
Mark Nelson	Computer Business Owner	Stitzer, WII	2004

Directors who are also agents are identified with an asterisk.

Members of the board and employee's currently receive $40.00 for each meeting attended and $.345 per mile for travel expenses. In addition, the company paid 70% of family health insurance premiums for all board members, and any agent who writes over $100,000 of annual premium. One agent was eligible to use this benefit at the examination date. Retired directors could elect to continue their group health insurance by paying 100% of the premium. As a cost reduction measure, effective September 1st, 2002 this benefit was discontinued.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at 12/31/01 and the present time are as follows:

Name	Office	2001 Salary
James Reed	President (2001 & 2002)	$ 4,536
Gary Schneider	Vice President (2001) Secretary/ Treasurer (2002)	560
William Frankenhoff	Secretary/Treasurer (2001)	4,180
Maurice Grim	Vice President (2002)	600
Robert Connor	Manager	37,305

The president and treasurer have the option of having 10% of their before-tax compensation paid into an individual retirement account.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. All members of the board of directors serve as the Adjusting and the Investment committees.

Growth of Company

The growth of the company since the last examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1996	$412,275	$127,096	1,319	$ 163,039	$1,974,042	$1,557,432
1997	428,360	287,086	1,283	(28,467)	2,085,912	1,583,025
1998	415,106	310,962	1,228	(122,651)	1,881,717	1,542,538
1999	507,346	359,648	1,465	(125,977)	2,183,984	1,754,741
2000	445,816	409,249	1,328	(140,842)	1,981,393	1,593,932
2001	429,800	352,109	1,303	(194,651)	1,767,246	1,320,609

The ratios of premiums written, gross and net, to surplus as regards policyholders since the last examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1996	$775,327	$460,893	$1,557,432	50%	30%
1997	699,883	417,648	1,583,025	44	26
1998	680,883	393,757	1,542,538	44	26
1999	765,577	527,283	1,754,741	44	30
2000	732,186	425,384	1,593,932	46	27
2001	759,558	444,792	1,320,609	58	34

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1996	$127,096	$303,299	$412,275	31%	66%	97%
1997	287,086	241,626	428,360	67	58	125
1998	310,962	293,078	415,106	75	74	149
1999	359,648	332,416	507,346	71	63	134
2000	409,249	291,313	445,816	92	68	160
2001	352,109	314,994	429,800	82	71	153

As shown above, the company has experienced unfavorable operating results since the last examination. The company reported net losses over five of the past six years. During this time period, policyholder surplus has decreased over 15% since the prior examination from $1,547,432 to $1,320,609. The company has experienced relatively unfavorable loss ratios over the past five years with the average being 77% and the high being 92%. The average for the town mutual industry was 75%.

A review of the company's expense ratio shows that it has consistently remained in the 58% to 74% range, with an average of 67%, which compares to an industry average of about 43%.

The examiners reviewed the company's current operating procedures and noted several cost reduction actions initiated by the new manager and the board of directors this year. In response to continuing underwriting losses the company raised its rates approximately 15% as of May 1, 2002. This was shortly after reducing agent commissions on February 1, 2002. The company plans to track claims annually by agent to identify agents with unusually high loss ratios. The manager, who is an experienced adjuster, will inspect every new policy and re-inspect and revalue each policy renewal on a three-year rotation personally. The manager will adjust all claims personally unless there is a need for specific expertise, at which point they will hire a specialized adjuster to assist him. The company also saw a need to expand the business, so the company will seek new profitable business in the counties where they have low representation and seek out partner agencies to assist them in this expansion. In response to the higher than average expense ratios, the health insurance premium benefit for directors and certain agents has been discontinued effective September 1, 2002. They are also looking at their business operating expenses line item by line item, period to period, to see if there is any further opportunity for expense reduction. They have begun to look at the business in a longer range prospective by preparing five-year business plans and multiple year budgets. These actions are relatively new and their effect may not be fully realized for a couple of years.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed that there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. The company's retention of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2002
Termination provisions:	January 1, 2003, or any subsequent January 1, by either party providing at least 90 days' advance notice in writing

The coverage's provided under this treaty are summarized as follows:

1.	Type of contract:	Class A - Liability Excess of Loss
	Lines reinsured:	All liability (non-property) business written by the company
	Company's retention:	$5,000
	Coverage:	100% of each and every loss over the company's retention occurring on the business covered by this contract, including loss adjustment expenses. Coverage is subject to maximum policy limits of $1,000,000 per occurrence in any combination bodily injury and property damage liability; $5,000 for medical per person, $25,000 per accident.
	Reinsurance premium:	50% of subject premium rates
2.	Type of contract:	Class B - First Surplus Reinsurance
	Lines reinsured:	All property business written by the company
	Company's retention:	$300,000 per ceded risk, including loss adjustment expenses.
	Coverage:	Up to $800,000 on a pro rata basis when the company's net retention is $300,000 or more in respect to a risk. When the company's net retention is $300,000 or less in respect to a risk, the company may cede on a pro rata basis up to 50% of such risk.
	Reinsurance Premium:	The pro rata portion of all premiums, fees, and assessments charged by the company corresponding to the amount of each risk ceded hereunder.
	Ceding Commission:	Minimum of 15% with a sliding scale up to 35%, depending on loss ratio.
3.	Type of contract:	Class C-1 Excess of Loss - First Layer
	Lines reinsured:	All property business written by the company
	Company's retention:	$35,000 per occurrence $35,000 annual aggregate deductible

	Coverage:	100% of any loss, excluding loss adjustment expense, in excess of $35,000, subject to a limit of liability to the reinsurer of $65,000.
	Reinsurance Premium:	Minimum Rate: 6% of the current net premiums written Maximum Rate: 22.6% of the current net written premiums Current Rate: 14.0% of the current net written premiums Minimum: $64,560
4.	Type of contract:	Class C-2 Excess of Loss - Second Layer
	Lines reinsured:	All property business written by the company
	Company's retention:	$100,000
	Coverage:	100% of any loss, including loss adjustment expense, in excess of $100,000, subject to a limit of liability to the reinsurer of $200,000.
	Reinsurance Premium:	2.4% of the company's current net premiums written in respect to the business covered hereunder Minimum Premium: $11,040
5.	Type of contract:	Class D/E Catastrophe and Stop Loss Reinsurance
	Lines reinsured:	All business written by the company
	Company's retention:	Part A Catastrophe Coverage: $100,000 per occurrence (excluding loss adjustment expenses) Part B Stop Loss Coverage: 75% of the company's net premiums written, subject to a minimum of $385,000
	Coverage:	Part A Catastrophe Coverage: Reinsurer shall be liable for 100% of the amount by which the loss exceeds the company's retention, but the liability of the reinsurer shall not exceed $250,000 as respects any one loss occurrence, nor shall it exceed $500,000 during each annual period this contract is in effect. One loss occurrence shall be limited to all individual losses sustained by the company occurring during any period of 168 consecutive hours. Loss occurrence is further limited as regards windstorm, hail, tornado, hurricane, and cyclone, including ensuing collapse and water damage, to all individual losses sustained by the company occurring during any 72 consecutive hours. Part B Stop Loss Coverage: Reinsurer shall indemnify the company for 100% of the amount, if any, by which the aggregate of the company's net losses (including loss adjustment expenses) during which this contract is in effect exceeds an amount equal to 75% of the company's net premium written.
	Reinsurance premium:	Current rate based on losses incurred by the reinsurer under this contract for the last eight years Minimum rate: 9% of the current net written premiums Maximum rate: 25% of the current net written premiums Current Rate: 14% of the current net written premiums

Minimum: $71,760

The above reinsurance contract covers up to $1,100,000 of risk. The company writes some risks that appear to be greater than that amount. See discussion of this issue in the section of this report captioned “Underwriting.”

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2001.

Liberty Mutual Fire Insurance Company
Statement of Assets and Liabilities
As of December 31, 2001

Assets	**Ledger**	**Non ledger**	**Not Admitted**	**Net Admitted**
Cash in Company's Office	$ 50	$	$	$ 50
Cash Deposited in Checking Account	21,899			21,899
Cash Deposited at Interest	709,485			709,485
Stocks or Mutual Fund Investments (at Market)	658,807	259,395		918,202
Real Estate (Net of Accumulated Depreciation and Encumbrances)	19,259			19,259
Premiums and Agents' Balances In Course of Collection	1,755			1,755
Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due	84,070			84,070
Investment Income Due or Accrued	2,475			2,475
Reinsurance Recoverable on Paid Losses and LAE	9,329			9,329
Electronic Data Processing Equipment – Excluding Software (Cost Less Accumulated Depreciation)	665			665
Fire Dues Recoverable	57			57
Other Assets: Furniture and Fixtures (Cost Less Accumulated Depreciation)	3,222		(3,222)	
TOTALS	$1,511,073	$259,395	$ (3,222)	$1,767,246

Liabilities and Surplus

Net Unpaid Losses	$ 86,001
Unpaid Loss Adjustment Expenses	3,672
Commissions Payable	10,665
Unearned Premiums	305,098
Reinsurance Payable	4,742
Other Liabilities:	
Expense Related	
Accounts Payable	10,261
Nonexpense Related	
Premium Paid in Advance	26,198
TOTAL LIABILITIES	446,637
Policyholders' Surplus	1,320,609
TOTAL	$1,767,246

Liberty Mutual Fire Insurance Company]
Statement of Operations
For the Year 2001

Net Premiums and Assessments Earned	$ 429,800
Deduct:	
Net Losses Incurred	321,589
Net Loss Adjustment Expenses Incurred	30,520
Other Underwriting Expenses Incurred	314,994
Total Losses and Expenses Incurred	667,103
Net Underwriting Gain (Loss)	(237,303)
Net Investment Income:	
Net Investment Income Earned	24,273
Net Realized Capital Gains	(279)
Total Investment Income	23,994
Other Income:	
Miscellaneous Income	18,658
Net Income (Loss)	$ (194,651)

Liberty Mutual Fire Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	$1,557,432	$1,583,025	$1,542,703	$1,754,741	$1,593,932
Net income	(28,467)	(122,486)	(125,977)	(140,842)	(194,651)
Net unrealized capital gains or (losses)	55,505	81,811	141,446	(21,078)	(78,351)
Change in non-admitted assets	(1,445)	353	(395)	1,111	(321)
Other gains and (losses) in surplus:					
Prior period adjustment			(25,532)		
Crawford Eastman merger			222,496		
Surplus, end of year	$1,583,025	$1,542,703	$1,754,741	$1,593,932	$1,320,609

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2001 is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company implement a plan to adjust the size of each class of directors to be as equal as possible.

   Action—Compliance, the company has adjusted the director class size to be equal. There are three classes of directors, each class elected to different three-year terms.

2. Conflict of Interest—It is recommended that the company implement a compensation package for the secretary/manager that does not include payments based on a percentage of commission on policies, which he is responsible for underwriting approval.

   Action—Compliance, the company has eliminated this compensation package based on percentage of commission on policies.

3. Underwriting—It is recommended that the company correctly answer interrogatory #4. The company stated its largest retained risk is $35,000, whereas one policy could retain $111,000 in losses.

   Action—Compliance, the company has developed a plan of analysis for the largest risk and prepares this interrogatory based on this analysis.

4. Underwriting—It is suggested that the company develop and use an analysis worksheet for large risks (over $1,050,000 - the normal limit of the reinsurance program) to determine the largest net fire risk and wind risk retained by the company on those policies.

   Action—Compliance

5. Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.

   Action—Compliance

6. Management and Control—It is recommended that the company not certify that a resolution was duly adopted by the board of directors when said resolution was not duly adopted by the board of directors.

   Action—Compliance, review of resolutions and board meeting minutes and determined that resolutions were duly adopted.

7. Invested Assets—It is again recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, regarding custody and control of its invested assets by maintaining its securities kept under a custodial agreement with a bank or banking and trust company.

   Action—Noncompliance, see comments in the summary of current examination results, Invested Assets.

8. Cash and Invested Cash—It is recommended that the company establish an asset on the annual statement for the amount of cash held in the company office.

   Action—Compliance

9. Book Value of Bonds—It is recommended that the company not invest more than 3% of assets in securities of any single issuer pursuant to s. Ins 6.20 (6) (f) (1), Wis. Adm. Code.

   Action—Compliance, the company no longer owns bonds.

10. Notes Receivable—It is recommended that the company report its Policyholders Mutual Insurance Company contribution note in Schedule G, Notes Receivable, and to properly non-admit the same in Exhibit 1, Analysis of Assets.

    Action—Not applicable

11. Amounts Withheld for the Account of Others—It is recommended that the company establish a liability for prepaid health insurance premiums paid to the company by participants covered under the group health insurance plan.

    Action—Compliance, the company has established an liability account for the prepaid health insurance premiums paid to the company by participants covered under the group health insurance plan as a adjustment to accounts payable at year end.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agencies. It was noted that the contracts do not include language indicating the agent will represent the company's interests "in good faith". It is recommended that the company execute formal written agreements with its agencies, which includes language indicating the agent will represent the company's interests in good faith.

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employee's which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Workers Compensation	$ 100,000 each accident $ 500,000 policy limit $ 100,000 each employee
Directors and Officers Liability	$1,000,000 general and aggregate $1,000,000 each occurrence $ 25,000 deductible
Building	$ 52,500 Bldg., $11,550 Equip. $ 250 deductible

Commercial Liability	$ 300,000 general and aggregate $ 100,000 each occurrence $ 5,000 medical expense
Errors and Omissions	$1,000,000 per claim $ 2,500 deductible
Fidelity Bond Coverage	$ 110,000 all employees

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and third year renewal business. Each new policy application, and every third year renewal policy is inspected and updated by the company's manager. All large policy risks are brought to the attention of the board of directors for review.

Claims Adjusting

The company has an adjusting committee consisting of all the directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to review the adjustment or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursement's journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2001.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computer is not limited to people authorized to use the computers. It is recommended that the company establish procedures to limit access to its computers. This could be accomplished by simply activating the password feature on each computer.

Company personnel back up the computers daily and the backed-up data is kept off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. The company's disaster recovery plan appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

> (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
>
> (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employee's of the company.

The company is not in compliance with these requirements. Furthermore, the two previous examinations have noted the company's non-compliance in this area. Since the last exam, the company sold its stocks and bonds that were not in compliance. However, the company currently owns a certificate of deposit that is held by a broker. It is again recommended that the company comply with s.

610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, regarding custody and control of its invested assets.

Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$746,637
2.	Liabilities plus 33% of gross premiums written	697,291
3.	Liabilities plus 50% of net premiums written	669,033
4.	Amount required (greater of 1, 2, or 3)	746,637
5.	Amount of Type 1 investments as of 12/31/2001	643,940
6.	Excess or (deficiency)	$(102,697)

The company does not have sufficient Type 1 investments.

The company was notified of this deficiency at which time they were directed to sell type 2 investments and purchased type 1 investments. During this exam, it was noted that the company has complied with the deficiency notice and is currently in compliance with the new investment rule. It is suggested that the company periodically review its investment portfolio and continue to maintain compliance with the investment rules described in s. 6.20 (6), Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$**731,434

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 50
Cash deposited in banks-checking accounts	21,899
Cash deposited in banks at interest	709,485
Total	$731,434

Cash in the company's office at year-end represents the company's petty cash fund. During the course of the examination, the examiners made a physical count and the balance was reconciled.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of nine deposits in seven depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2001 totaled $46,114 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 3.0% to 6.7%. Accrued interest on cash deposits totaled $2,475 at year-end.

Stocks and Mutual Fund Investments **$**918,202

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2001. The company’s Wisconsin Reinsurance Corporation and NAMIC stock certificates are kept in the company safe.

The examiners physically examined stock certificates. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was not in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. The company was granted an exception to exceed its investment in stock and mutual funds from the original amount of 25% of assets to an increased amount of 40%. As of 12/31/01, the company exceeded this percentage, but due to the sale of their type 2 investments and the purchase of type 1 investments mentioned in the Investment Rule Compliance section above, it was estimated that they are currently in compliance with

Wisconsin Statutes and the rules of the Commissioner of Insurance as regards to their percentage of Stock and Mutual fund investments.

Dividends received during 2001 on stocks and mutual funds amounted to $1,692 and were traced to company records. The company had no accrued dividends at December 31, 2001.

Book Value of Real Estate **$**19,259

The above amount represents the company's investment in real estate as of December 31, 2001. The company's real estate holdings consisted of their office building.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance in regards to investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums **$**85,825

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. This balance is made up of Premiums in Course of Collection of $1,755 and Premiums Booked but Deferred and Not Yet Due of $84,070. A review of individual agent's accounts verified the accuracy of this asset.

Investment Income Due and Accrued **$**2,475

Interest due and accrued at December 31, 2001 was related to the company's certificates of deposit.

Reinsurance Recoverable on Paid Losses **$**9,329

The above asset represents recoveries due to the company from reinsurance on losses, which were paid on or prior to December 31, 2001. A review of year-end accountings with the reinsurer and subsequent receipts verified the above asset.

EDP Equipment **$**665

This asset consists of computer equipment. The amount reported is net of accumulated depreciation and excludes software. The examiners verified this asset amount by physical inspection and by reviewing the method of depreciation.

Fire Department Dues Recoverable **$**57

This asset represents the fire department dues recoverable at December 31, 2001. The examiners reviewed the company's fire department dues calculation and found this asset to be correctly calculated.

Equipment, Furniture, and Supplies **$0**

This asset consists of $3,222 of office furniture and equipment owned by the company at December 31, 2001. The company is using the seven-year MACRS method to depreciate this asset and the amount reported is net of accumulated depreciation. It is properly recorded as a non-admitted asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$**86,001

This liability represents losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$183,609	$153,023	$30,586
Less:			
Reinsurance Recoverable on Unpaid Losses	97,608	90,594	7,014
Net Unpaid Losses	$ 86,001	$ 62,429	$23,572

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2001. To the actual paid loss figures was added an estimated amount for those 2001 and prior losses remaining unpaid at the examination date. The company's balance of Net Unpaid Losses at December 31, 2001 appears adequate.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly, except as described below, and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

The examination also noted that the company routinely allows claims to remain open for a number of years without settlement, the company waiting for information from the claimant or for the insured to repair covered damages. This practice may be interpreted to be an unfair settlement policy by failure to initiate and conclude claim investigations in a reasonable period of time. It also increases the company’s exposure to additional loss sustained on damaged and unrepaired property. It is recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Unpaid Loss Adjustment Expenses **$**3,672

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2001, but which remained unpaid as of year-end. The company used 2% of total gross unpaids to estimate this liability.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$**10,665

This liability represents estimate of commissions payable to agents as of December 31, 2001, that will be paid on premiums, agents' balances, and installments booked but deferred and not yet due. The company's estimate of future commission payments was deemed reasonable.

Unearned Premiums **$**305,098

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Reinsurance Payable **$**4,742

This liability consists of amounts due to the company's reinsurer at December 31, 2001, relating to transactions, which occurred on, or prior to that date.

Class A-Excess of Loss	$(1,391)
Class C-1-Excess of Loss First Layer	(2,100)
Class C-2-Excess of Loss Second Layer	(500)
Class D/E-Stop Loss	(2,100)
Deferred Reinsurance Premium Payable	10,833

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Other Liabilities – Accounts Payable **$**10,261

The reported balance consists of a liability for miscellaneous expense items. Miscellaneous expense items payable as of a December 31, 2001 include the directors group health plan contributions. Actual amounts payable were verified to canceled invoices and payment records. Review of paid invoices through the examination date supported the adequacy of the company's liability.

Other Liabilities – Premium Paid in Advance **$**26,198

This amount represents the liability for premiums received by the company in 2001 for policy effective dates in 2002. Advance premiums were validated by tracing selected premiums from applicable cash receipt records. Reconciling differences of approximately $546 were determined to be due to installment fees paid and nominal refunds.

V. CONCLUSION

Liberty Mutual Fire Insurance Company is a town mutual insurer operating in a seven-county area of southwestern Wisconsin. The company has been in business for 130 years, providing property and liability insurance to it policyholders.

Overall, the size and financial position of the company has declined since the prior examination as of December 31, 1996. The policyholder count has decreased from 1,319 to 1,303 since the prior examination. The company has experienced unfavorable operating results since the last examination. The company reported net losses over five of the past six years. During this time period, policyholder surplus has decreased over 15% since the prior examination from $1,547,432 to $1,320,609

The company has experienced relatively unfavorable loss ratios over the past five years with the average being 77% and the high being 92%. The average of all the town mutuals was 75%. A review of the company's expense ratio shows that it has consistently remained in the 58% to 74% range, with an average of 67%, which compares to an industry average of about 43%.

The current examination resulted in four recommendations, one of which was repeated from the prior report, and one suggestion. The recommendations and suggestion are listed on the following page. The examination resulted in no adjustment to surplus.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 17 - Corporate Records—It is recommended that the company execute formal written agreements with its agencies, which includes language indicating the agent will represent the company's interests in good faith.

2. Page 19 - EDP Environment—It is recommended that the company establish procedures to limit access to its computers.

3. Page 19 - Invested Assets—It is again recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, regarding custody and control of its invested assets.

4. Page 20 - Investment Rule Compliance—It is suggested that the company periodically review its investment portfolio and continue to maintain compliance in the investment rules described in s. 620.22 and 620.23 Wis. Admin. Code.

5. Page 24 - Net Unpaid Losses—It is recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Sheur Yang of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Russell Lamb
Examiner-in-Charge